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As I see

THE NEW FHA PROVISIONS

ON August 5, 1957, the Administration cut the minimum downpayments on homes with mortgages insured by the FHA. It raised the maximum permissible interest rate to 5-1/4% from 5% on FHA-insured mortgages. It also set maximum discounts on FHA and VA mortgages, and set new purchase prices that the Federal National Mortgage Association will pay for FHA- and VA-insured mortgages in secondary market operations. It eliminated the prepayment on the first year's insurance premium formerly required, thus reducing still further the amount of money needed at the closing of the sale.

What effect will these moves have on real estate and new construction?

I have long advocated that interest rates on all types of mortgages, insured and uninsured, should be left free to fluctuate with the market. An interest rate is the price that a borrower pays for a loan, and there is no more reason why price-fixing in the field of mortgage lending will work than there is in the field of commodities and services. If demand exceeds supply for sugar, copper, engineers, or mortgages, the price should rise, and the increased price will have a tendency to decrease the demand and to increase the supply until the two are in balance. To increase the permissible rate will be of some help, but will not help as much as it would to free interest rates of all limitations. If 5-1/4% is high enough to attract the necessary amount of money into real estate loans, there is no reason for putting a ceiling on the rate, as it would not rise above this unless insufficient money were attracted. If, on the other hand, the rate is not high enough, limiting the interest rate to 5-1/4% will automatically prevent real estate from securing the financing it needs. What we have actually been witnessing, in the raising of these rates from time to time, is a belated acknowledgement on the part of the Government that its rates were unrealistic, and that, in order to make money available, it had to come closer to the rates on conventional mortgages fixed in the market.

The raising of the permissible interest rate on FHAs has caused a clamor among some Congressmen who are good politicians but economic illiterates. One in particular was quoted as saying, "Apparently this Administration cannot take any action in the financial field which does not benefit the big banking interests in some way." He would apparently rather see his constituents denied the advantages

of FHA insurance by restricting the rate to the point where lenders would find other investments more attractive than he would to see them pay a rate high enough to enable real estate to secure the financing it needs in competition with other groups needing capital.

It seems inconceivable that a member of Congress could have isolated himself so far from the economic picture that he would be unfamiliar with the increase which has taken place in the price of money. When the Federal Government has to pay more than 3% on 91-day Treasury bills, and when most large banks have increased their short-term prime rate to 4½%, it is unreasonable to expect lenders to prefer mortgage investments at 5%, or even 5-1/4%.

A few years ago most of the large life insurance companies of the United States had a large percentage of their assets invested in Government bonds. In 1945, for instance, 46.8% of the assets of the 60 largest life insurance companies in the United States were invested in this manner. At that time, only 14.3% of their assets were in real estate mortgages. They have consistently reduced their Government bond accounts, until last year only 7.5% of their assets were in Government bonds. They have increased their mortgage accounts until more than a third of their assets are in mortgages. The drop in the Government bond account amounted to more than $13 billion. The increase in the mortgage account has been almost $24 billion, the difference coming from the growth of these companies. It is clear that real estate cannot expect a great deal of financing from life insurance companies due to the further sale of Government bonds, as the amount in bonds is approaching an irreducible minimum.

I think at this point it should be emphasized that the prime responsibility of a life insurance company is to its policyholders and not to furnish funds through the purchase of Government bonds to the Federal Government, nor is its responsibility to the real estate operator as a source of mortgage money. A trustee of a life insurance company should be interested only in one thing, the greatest safety for his policyholders' money with the largest financial return. If I knew that the life insurance company in which I have my policies had been persuaded that its primary responsibility was to furnish operating capital for this or for that in order to achieve some so-called social aim, I would cash out my policies in that company and put the money with some other organization which was primarily interested in guaranteeing that the purpose for which I took out this insurance would be achieved without risk. Any financial organization which is entrusted with funds by the public has the same responsibility, and must constantly weigh one investment opportunity against another. Only in a market where interest rates are allowed to fluctuate freely will it be possible for real estate to get the amount of money needed to finance new and existing properties.

To attempt to set discounts on FHAs is again a price-fixing attempt which will be no more successful than other price-fixing attempts have been in the past. Loans are discounted because the interest rate at which they are made is not high enough to attract capital. There should be no limit on discounts since there is a

limit on the mortgage interest rate, as only through discounts can an unrealistic rate be adjusted to the point where it will attract the needed money.

In an attempt to make price-fixing work, the Federal National Mortgage Association was given the right to buy mortgages which other investors did not consider attractive. It is a thinly disguised method of direct Government lending, more objectionable, in my opinion, than for the Government to throw aside all sham and camouflage and to go into the mortgage market in an honest fashion. If the Government were making billions of dollars of direct Government loans, there would be a tremendous outcry against it from many directions, but as it is, Fannie Mae has become the sweetheart of many former rugged individualists in the building, real estate, and mortgage fields. For a mortgage lender to make a mortgage which he could not otherwise sell, with the idea of dumping this mortgage with the Federal National Mortgage Association, is in contradiction to the principle of the shared risk, which we have advocated in our reports many times in the past. We have said in these reports that if a home owner buys a home and his judgment is poor and the price of the home declines, he should share in the loss; also, if a mortgage lender makes a mortgage and his judgment proves poor, he should share in the loss. Unless this is true, if profits can be made by individuals but losses can be passed off on the taxpayer, the result inevitably will be that the taxpayer will hold the bag.

The reduced downpayments permissible on homes with loans insured by the FHA do not necessarily mean that more mortgage money will be available on these terms. There is no assurance that mortgage lenders, even on an insured basis, will agree to lend more on a $10,000 house than the seller receives after paying the sales commission, which is his opinion of its value in the market. The $300 downpayment which the purchaser is required to pay on this house under the new FHA regulations, added to his payments for the first year, is only sufficient to pay the sales commission.

I think this reduced downpayment may stimulate some marginal building. I think it will not produce any very large volume, but I am considerably worried about the increasing use of stimulants in the real estate market. Adrenalin has saved many lives by carrying a patient over a crisis, but no one can continue for long on regular doses. We are running out of effective stimulants. When this last one wears off, the only way that home ownership can be made more financially attractive to many persons not now home owners will be to do away with downpayments altogether. Even this in time would lose its attractiveness, and it might be necessary to offer some sort of a payment in cash to the purchaser which would then be added to the mortgage. This has been done on occasions in the past.

I think a part of the fallacy in this whole approach is that many people believe that home ownership can be sold to the public only on the basis that its cost in dollars is low Many worthwhile things come high. To me it is not a question of proving that home ownership is cheaper than renting, but that the home owner has many satisfactions which the renter will never know.

Many years ago, Saunders Norvel was conducting a meeting of the salesmen of the Norvel-Shapleigh Hardware Company. His enthusiasm probably carried him away, as he made the statement that any article in their line could be sold to anybody if the proper sales motive were found. One of the salesmen challenged him, and he agreed that he would endeavor to sell any article which this salesman selected from their stock to anyone that he would choose. The article decided on was a solid gold door key, selling for $75, which was a lot of money in those days. The man selected to whom he was to make the sale was a Scotch banker. Norvel put the key on a key chain, dropped it in his pocket, and went over to see the banker. During the course of the conversation he took the key chain out of his pocket and twirled it around his finger. The banker noticed the key and asked him what it was. Norvel told this story.

> "I am supposed to be a hard-boiled businessman, but at heart, like most other businessmen, I am sentimental. My home is the place where I can get away from all the worries and troubles of business, and the lock on my front door symbolizes to me the escape from all the problems which I encounter during the day. This solid gold key is the key that opens that door."

He then changed the subject and, after a casual conversation of a few minutes, left. A few days later the Scotch banker called him and said, "I have been thinking about that story you told me about your gold key. My daughter is getting married next month and I would like to get a similar key for her new home. While you are about it, make up another one for me."

There are many arguments for home ownership which I believe have greater validity than the fact that home ownership is cheaper than renting.

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